

AR56



Search Energy Corp.

Western
University
1-18 Business Building
Edmonton, Alberta T6G 2R6

realizing our ongoing potential has been the challenge of 1998.

We had a year of improved financial results, improved efficiencies and dramatically improved

production. We are realizing the unrealized

1998 Annual Report



	94	95	96	97	98
Reserves (mboe)	5	500	2,551	4,518	7,295
Cash Flow (\$ thousands)	\$56	\$53	\$832	\$4,028	\$6,009
Wells Drilled					
Gross	—	2.0	6.0	14.0	25.0
Net	—	1.0	4.5	6.6	17.8
Significant Events	Founding of the Company.	Begins trading on the Alberta Stock Exchange.	Acquisition of Westrex Energy Corp.	Search initiates trading on the TSE and later acquires Lionheart Energy Corp.	A unique acquisition from Petro-Canada creates an excellent platform for growth.



Search Energy Corp.

Search is dedicated to *realizing the unrealized* in a turbulent industry environment where superior training, skills and creative ideas are critical to success. Since the inception of the Company, significant growth has been fueled by exploration, development and uniquely structured acquisitions that have maintained a strong balance sheet. The Search team is dedicated to providing exceptional returns to shareholders by *realizing the unrealized*.

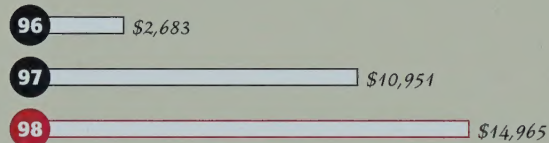
1998 Annual Report



realizing

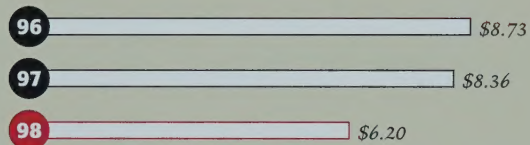
Revenue

(\$ thousands)



Operating Costs

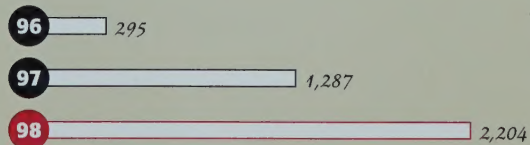
(\$/boe)



the unrealized

Production

(boed)



president's message

Search Energy Corp. posted another year of substantial growth and improved financial results, despite confronting one of the most difficult operating environments ever experienced by the oil and gas sector.

Even though the collapse in world crude oil prices caused a slowdown in industry activity, Search increased its oil and gas reserves by 68 percent, almost 3.3 times its 1998 production of 804 mboe. Production volumes were up 71 percent to 2,204 boed. Due to the deterioration of crude oil prices, cash flow improved only 49 percent to \$6.0 million which caused a disappointing retreat in cash flow per share to \$0.16 from \$0.18 in 1997.

A critical achievement was a reduction in the Company's cost of production, most notably a 26 percent decline in operating costs to \$6.20/boe. This was a fundamental factor behind the Company once again generating a healthy profit. On a per share basis, earnings equated to \$0.02 in 1998 compared with \$0.03 in 1997.

These accomplishments led the Search team to the theme of our 1998 annual report:

realizing the unrealized. In its fourth year of operations, Search became a significant player within its key operating areas. A record number of wells were drilled with a good success ratio. The undeveloped land base more than doubled, while the technical staff has created a handsome inventory of prospects. At the same time, the Company's ability to realize additional value from its asset base fueled a significant portion of growth in 1998.

Realizing the unrealized also reflects a business style that pervades the Company's entire operations. Search's fundamental strategy is to focus effort on areas that can materially impact the Company's growth and value. As Search operates the vast majority of its properties, it has the control and the team dedication for continual improvements – and a sense of ownership that leads to creative solutions. To help foster this environment of achievement, performance targets are set and results are monitored regularly.

Realizing the unrealized is also a fundamental philosophy for finding or creating opportunities to grow the Company. In the current low oil price environment, successful companies will be those that can maintain a strong balance sheet, and still fund growth. Search will

be one of those companies. An exceptional team is in place with the experience and skill to maintain financial strength while pursuing aggressive growth. This was particularly evident in 1998 when Search completed a unique acquisition that gave the Company operatorship of high quality assets, while assuming no debt.

In May, Search raised \$3.1 million in units comprised of flow-through shares and purchase warrants which funded a portion of the Company's activity and strengthened its financial position. In September, Search purchased a subsidiary company (765467 Alberta Ltd.) with significant assets from Petro-Canada, one of Canada's largest integrated oil and gas companies. The transaction was completed for shares in Search, resulting in Petro-Canada becoming the Company's single largest shareholder. This acquisition, of which we are proud, was completed at a low cost and gave Search properties, including high impact gas areas that are a significant platform for growth.

Following on the success of this unique transaction, Search negotiated a second asset acquisition for cash from Petro-Canada which closed on March 15, 1999. This \$6.7 million acquisition added 535 boed of production, primarily natural gas, operated infrastructure and top notch exploitation and exploration potential in the multi-zone Stoddart/North Pine area in B.C.

Having added such tremendous growth potential, Search remains committed to managing its asset base to generate the greatest value.

In response to falling oil prices in 1998, Search increased its natural gas production to 37 percent of total production from 28 percent in 1997. This helped support cash flow by offsetting the impact of low oil prices. In 1999, Search is targeting a further increase in the natural gas portion of production to 50 percent. At the same time, Search will retain valuable exposure to crude oil when favourable prices return.

To further insulate the Company from price declines, Search disposed of non-core assets with low working interests or high operating costs. This generated proceeds of \$3.4 million and allowed Search to high-grade its asset base.

During 1998, Search maintained a constant watch on its debt level. The Company's year-end total debt of \$14.0 million, including working capital, was one of the healthiest among its group of peer companies and well within the current line of credit of \$22.0 million. This relatively low level of leverage will expose Search to opportunities unavailable to companies with more highly leveraged balance sheets.

Industry Conditions

While the oil and gas sector regularly experiences cyclical commodity pricing, the magnitude of the drop in oil prices combined with the duration is unprecedented. The impacts have been far reaching. Investors retreated from petroleum stocks causing a dramatic fall in the Toronto Stock Exchange Oil and Gas Index and a collapse in equity markets. Activity levels in the field dropped significantly from record highs in 1997 as many companies were forced to cut capital spending. Many companies are facing flat to declining growth as funds are not available to expand exploration and development, or for acquisitions.

Although crude oil prices have recently begun to rise, we at Search remain somewhat skeptical that production constraints by OPEC members will lead to a sustainable return to prices more in line with historical norms. World oversupply, the major factor for the initial price drop, is not likely to disappear until world demand levels increase to a point achieving equilibrium. In our opinion, this is unlikely to occur before the economic crisis in Asia is well past.

The outlook for natural gas prices is more positive, although there may be volatility over the next year. Despite two warm winters across North America, natural gas prices have remained strong. This price strength has been fueled by substantial new pipeline

export capacity from Alberta which came onstream in December 1998. In the past, pipeline capacity was limited and the competition for transportation resulted in Canadian producers receiving a discounted price compared to U.S. benchmark prices. The differential has narrowed considerably supporting increases in natural gas prices.

Outlook

Search is excited about its prospects for the next year, and its ability to capture opportunities in the current industry environment. We have tremendous upside potential in our expansive land base and a strong inventory of high quality prospects. Search will continue to high-grade its asset base through dispositions, while focusing on exploration and development of core properties. With the more positive pricing forecast for natural gas, Search is continuing to focus on exploitation of its natural gas assets, specifically in the Bezanson and Stoddart/North Pine areas acquired from Petro-Canada, as well as additional drilling in the Wainwright area. We are also evaluating acquisition and disposition opportunities and ways to creatively structure deals to ensure we maintain a sound balance sheet.

Capital expenditures are currently budgeted at \$19 million including the Stoddart/North Pine

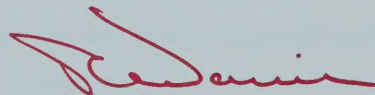
acquisition. Funding will come from a combination of cash flow and available lines of credit. The majority of expenditures will be dedicated to natural gas activities. This level of spending is expected to result in production averaging 18 mmcf and 1,600 bopd for the year. Cash flow for the year is forecast between \$10.0 and \$11.0 million based on an average oil price of U.S. \$13.00 WTI and an Alberta average gas price of \$2.40/mcf.

Search is not optimistic about growth in commodity prices. However, we are very optimistic about growing the Company. Search is dedicated to realizing the unrealized with a team of outstanding professionals with the talent, training and track record to create value for our shareholders.

Of special interest to shareholders is the recent formation of a committee comprised of independent directors and a Company officer. The Independent Reserve Evaluation Committee will provide shareholders with greater assurance of the value assigned to Search's reserve base by meeting privately with the Company's independent evaluators.

Mr. Gary Bourgeois is not standing for re-election to the Board of Directors and I would like to acknowledge his service and valuable advice to the Company over the past two years.

I would like to personally thank everyone who has supported Search Energy during a challenging year. The tremendous efforts of our employees were integral to our strong performance in 1998, our Board provided invaluable guidance, while our shareholders have been supportive as we build a Company dedicated to *realizing the unrealized* and to providing exceptional returns.



William T. Davis

President and Chief Executive Officer

April 15, 1999

Search Energy Corp.

operations review

Search's operations are guided by select criteria aimed at increasing value.

Acquisitions and Dispositions

- *target acquisitions with significant potential to increase value*
- *acquire properties in core areas*
- *high-grade the asset base through dispositions*

Exploitation

- *enhance production*
- *operate essentially all properties with high working interests*
- *focus on maintaining low operating costs*

Exploration

- *internally generate plays using leading technology*
- *target prospects with multiple-stacking zones*
- *focus on low to medium risk plays*

1998 Annual Report

Search typically gains entry into a core area through a property acquisition, and then dramatically increases value through internally-generated exploration and development. With drilling success and new acquisitions, Search will dispose of assets so resources can be focused on areas with the greatest growth potential.



4 core areas

	<i>Percentage of Production*</i>	<i>Percentage of Proven and Risked Probable Reserves*</i>	<i>Percentage of Undeveloped Land*</i>	<i>Operatorship of Facilities in Major Properties</i>
Northeastern British Columbia	16%	24%	22%	Yes
Alberta Peace River Arch	28%	22%	26%	Yes
East-central Alberta	35%	33%	36%	Yes
Southeastern Saskatchewan Southwestern Manitoba	21%	21%	16%	Yes

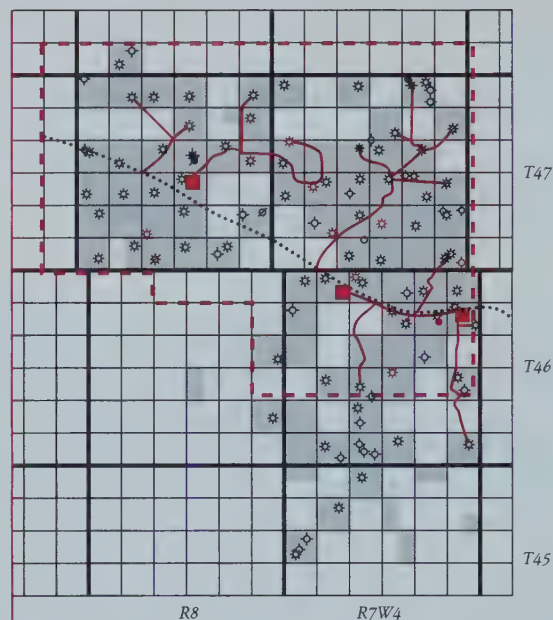
* As at March 1999

East-central Alberta

Wainwright Twenty-one percent of Search's production, all natural gas, comes from this low cost area. Wainwright is characterized by multi-zone gas and medium to heavy oil targets at shallow depths above 850 metres. Search operates and has an 87.5 percent interest in the gas gathering and compression facilities which allows for rapid full-cycle development. From seismic evaluation through drilling and tie-in, wells can be brought onstream within two months.

While currently a gas play, there is also significant medium to heavy oil potential. Within a 12 mile radius of Search lands, drilling has established 350 mmbbls of oil reserves. Through a 1998 heavy oil seismic option agreement, a discovery drilled on Search lands produced at rates up to 60 bopd. Of greater significance, the agreement provided Search with 300 square kilometres of 3-D seismic shot over Search lands.

1998 Activity Search drilled nine gas wells with initial rates averaging 750 mcf/d per well. One oil well was drilled and completed, but was shut-in due to low field netbacks. As well, one dry hole was drilled and abandoned. Seismic indicates that a number of small, high quality gas pools remain to be drilled. Field compression was added at two sites to improve rates and recovery.



Search Land
 3D Seismic Coverage
 NUL Gathering Line
 Compressor

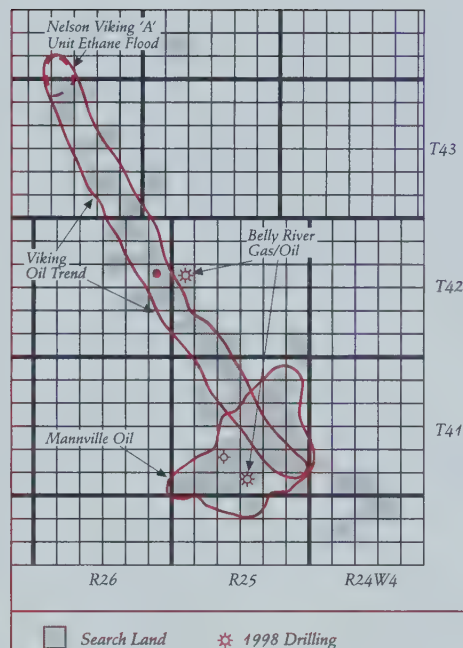
- 1998 drilling increased gas production by 400 percent to 6.5 mmcf/d.
- Netbacks are high due to approximately 50 percent of Search's lands being fee simple title and effectively royalty-free.
- Excellent upside exists for adding gas reserves, and heavy oil when prices improve.
- Search's average working interest is 87.5 percent.
- In 1999, Search plans to shoot additional seismic and drill up to six wells.

East-central Alberta

Chigwell The Chigwell area produces 14 percent of Search's production which in 1998 averaged 475 boed. Light oil and gas are produced from seven formations to a depth of 1,800 metres. Enhanced recovery and uphole completions continue to generate opportunities to increase production.

A dramatic increase in upside potential is being evaluated through an experimental ethane flood and pressure enhancement project which commenced in summer 1998. The project, located in the Nelson Viking 'A' Unit, is expected to improve recovery of oil in place from the current 10 percent to at least 25 percent and perhaps as high as 40 percent. Search has a three percent interest in the unit. Initial pressure and injection rates have been positive, however, results won't be known until mid-1999. If successful, Search will evaluate employing the same technology on developed lands along trend where it holds up to 60 percent working interests.

1998 Activity Search drilled two exploratory wells in 1998, one a successful gas well. This Belly River well was tied-in in first quarter 1999. Four development wells were completed for Belly River gas and oil production. Results ranged from 200 mcf/d to 2 mmcf/d, and 40 bopd of light oil.



- Successful exploration and development continue to maintain production rates.
- Success of an ethane flood project could significantly increase Search's light oil reserve recovery.

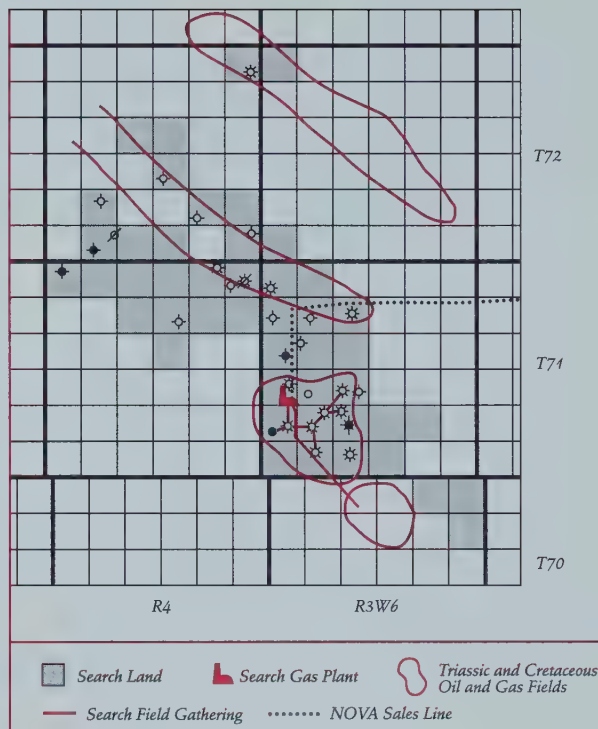
Alberta Peace River Arch

Search owns several properties in this gas-prone multi-zone area.

Bezanson This Search-operated property was acquired in late 1998 and is located on the Peace River Arch, a prolific area with multiple shallow gas and light oil prospects at depths up to 1,800 metres.

Several Cretaceous sweet gas zones are productive in the area, and there is deeper oil and gas potential in the Triassic. Search operates a 100 percent working interest sweet gas plant capable of 20 mmcf/d which processes Search's as well as third party gas.

1998 Activity Five existing wells were recompleted or tested at Bezanson to confirm productivity. Oil and gas rates indicate the presence of an oil field similar to the Manir Charlie Lake oilfield several miles to the northeast. As part of Search's long-term commitment to this area, 740 kilometres of 2-D seismic was purchased. Search also has access, at no cost, to 250 kilometres of Petro-Canada seismic shot over Bezanson. As well, Search drilled two wildcat prospects in this core area. Although these wells were dry, they earned Search interests in the nearby Kaybob and Cornwall properties.

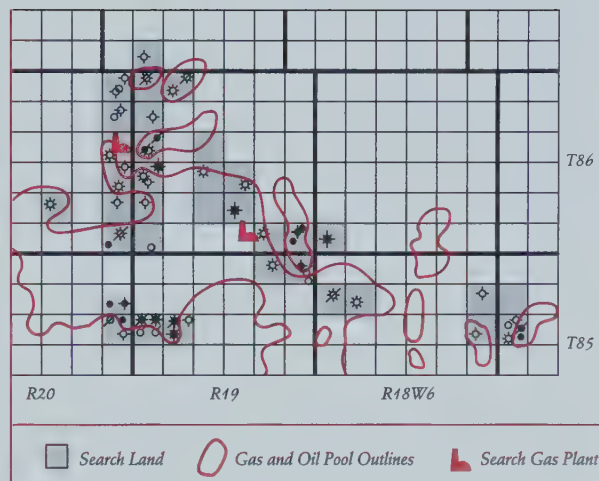


- Search has 54 sections of land at Bezanson, most of which is undeveloped and at a 100 percent working interest.
- Drilling in second quarter 1999 will focus on delineating oil and gas pools.

Northeastern British Columbia

Stoddart/North Pine The Stoddart/North Pine property was acquired in the first quarter of 1999 and contributes 16 percent, or 4.8 mmcf/d and 50 bopd, to Search's production. This area of the B.C. Peace River Arch has produced from deep gas reservoirs for the last 40 years, with up to 12 shallower oil and gas formations. Search operates the gas gathering system and two field processing facilities that service the area. Twenty of 34 sections of land have undeveloped potential gas zones.

The original producing deep gas zones have delayed shallow development on the Search lands. Limited seismic control, no recent drilling and numerous uphole leads suggest many opportunities will present themselves after additional evaluation work is done.

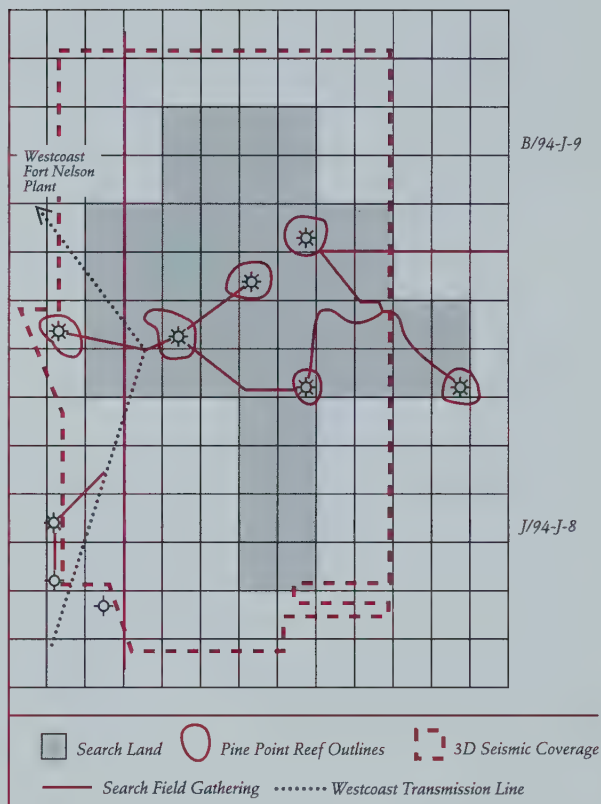


- Stable sweet gas production is processed in operated facilities.
- Uphole potential exists in producing wells.
- Abundant high interest undrilled lands await seismic acquisition and evaluation.
- The area has year-round access and multi-zone potential.

Northeastern British Columbia

Klua This gas field was acquired in late 1998. Eight bcf of natural gas remains to be produced from five shut-in wells. The wells were drilled by Petro-Canada between 1989-91 and produced from the Devonian Pine Point horizon capable of sales gas rates exceeding 14 mmcf/d and with reserves ranging from 5 to 20 bcf per well. The wells are tied-in to Westcoast Pipeline's Fort Nelson plant where processing of the acid gas is required to achieve sales quality. The wells are presently suspended as the field facilities were removed in 1997. Search holds 5,400 net acres of undeveloped land in the region with the potential for high impact natural gas plays.

1998 Activity Search processed and interpreted 25 square kilometres of existing 3-D seismic covering the Klua field and adjacent area. Results are encouraging and field re-commissioning is scheduled for 1999-2000.



- Additional seismic is being shot in 1999 to delineate a drillable structure.
- Development options are being reviewed to increase field netbacks.
- Drilling operations are scheduled for fourth quarter 1999.

S.E. Saskatchewan/S.W. Manitoba

Twenty-one percent or 700 bopd of Search's production comes from operated oilfields in the Williston Basin area of S.E. Saskatchewan and S.W. Manitoba. These oil pools generally contain 1 to 2 mmbbls of light oil. The relatively small size is balanced by low risk drilling, rapid well payout and an attractive royalty regime. Search has five main operated oilfields. In 1998, activity was directed toward two of them – Pierson and Morrisview.

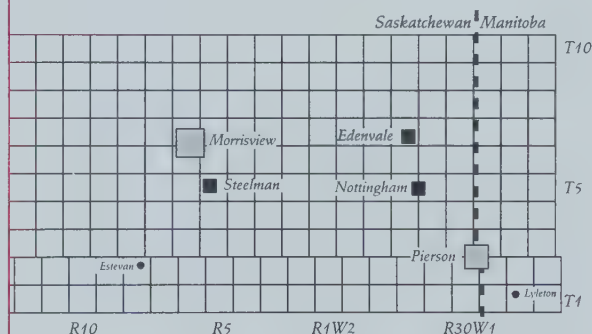
Pierson, Manitoba Search employed a processing and interpretation technique to increase the resolution in its 3-D seismic data which improved its drilling success.

1998 Activity Search drilled four horizontal development wells which added net 300 bopd. A new pipeline-connected oil battery improved fluid handling capability and reduced operating costs 35 percent to \$6.10/boe.

One mile away at Pierson East, a wildcat vertical well encountered a new pay zone. The discovery was immediately re-drilled with a horizontal leg which produced up to 200 bopd. Further mapping confirms this new pay zone extends across Search lands setting up several new potential drilling locations.

Morrisview, Saskatchewan Morrisview has been undergoing field optimization for low risk, light oil.

1998 Activity Production increased significantly following drilling of a 100 percent Search horizontal well in the second quarter. The well flowed clean oil at a rate of 300 bopd. Additional land was acquired in this area on a similar prospect for future drilling.



- *Field optimization was conducted at Steelman to extend reserve life.*
- *At Edenvale and Nottingham, operating costs were reduced.*

operations

Land Review Search Energy continues to maintain a large inventory of prospective acreage to ensure an active drilling program and fuel continued growth of the Company. In 1998 Search increased its undeveloped land base by 85 percent.

<i>Undeveloped Land (acres)</i>	<i>1998</i>		<i>1997</i>		<i>1996</i>	
	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>
<i>S.E. Saskatchewan/S.W. Manitoba</i>	32,368	21,619	26,816	15,724	31,225	20,383
<i>Alberta</i>	143,291	78,747	74,757	45,075	30,658	19,738
<i>British Columbia</i>	14,140	11,784	—	—	—	—
<i>Total</i>	189,799	112,150	101,573	60,799	61,883	40,121

Search's undeveloped land grew by 51,351 net acres in 1998. The purchase of 765467 Alberta Ltd. from Petro-Canada contributed 32,726 net undeveloped acres. The remaining 18,625 acres were purchased, primarily at 100 percent working interests, providing Search with control of prospects under development. A lower level of industry activity in 1998 resulted in reduced land prices. Search will continue to take advantage of these circumstances to build its prospect and land inventory in and around its core properties.

Drilling Activity During 1998, Search drilled a record 25 wells (17.8 net), compared to 14 wells (6.6 net) in 1997. Search's net success ratio in 1998 was 67 percent, up from 57 percent in 1997.

<i>Drilling Activity</i>	<i>1998</i>		<i>1997</i>		<i>1996</i>	
	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>
<i>Oil</i>	8.0	4.4	4.0	2.2	6.0	4.5
<i>Gas</i>	9.0	7.5	2.0	1.3	—	—
<i>Service</i>	—	—	1.0	0.3	—	—
<i>Dry and abandoned</i>	8.0	5.9	7.0	2.8	—	—
<i>Total</i>	25.0	17.8	14.0	6.6	6.0	4.5

Exploration wells accounted for 40 percent of 1998 drilling. The majority of Search's 1998 drilling was at Wainwright, Alberta where 11 wells (9.6 net) were drilled, and Pierson, Manitoba and Morrisview, Saskatchewan where six wells (3.5 net) were drilled. The remaining eight wells (4.7 net) were drilled on exploration prospects in Alberta and Saskatchewan.

Production Search's 1998 production averaged 2,204 boed compared to 1,287 boed in 1997, an increase of 71 percent. In 1998, average production was split 37 percent natural gas to 63 percent oil.

Natural gas production increased 125 percent in 1998 to 8,206 mcf from 3,651 mcf in 1997. Exploration and development drilling, primarily at Wainwright, Alberta accounted for 86 percent or 3,938 mcf of the 1998 average incremental gas production. An average 617 mcf was added by the acquisition of 765467 Alberta Ltd. from Petro-Canada.

Oil and liquids production grew 50 percent in 1998 to 1,383 from 922 bopd in 1997. Production gains were primarily due to development drilling at Pierson, Manitoba and Morrisview, Saskatchewan, with some additional volumes acquired in the acquisition from Petro-Canada.

Production Volumes	1998	1997	1996
<i>Total oil production (mbbls)</i>	505	337	94
<i>Total gas production (mmcf)</i>	2,995	1,332	136
<i>Daily oil (bbls)</i>	1,383	922	258
<i>Daily gas (mcf)</i>	8,206	3,651	373
<i>Daily total (boe)</i>	2,204	1,287	295
<i>Exit oil (bopd)</i>	1,584	1,068	831
<i>Exit gas (mcf/d)</i>	11,030	5,592	2,183
<i>Exit total (boed)</i>	2,687	1,628	1,050

Reserves All of Search's reserves were independently evaluated at year-end 1998 by McDaniel & Associates Consultants Ltd. Year-end proven reserves were determined to be 6,582 mboe, a 68 percent increase over year-end 1997. Proven and probable reserves increased 54 percent to 8,008 mboe.

Search's year-end 1998 proven natural gas reserves increased 106 percent to 29.5 bcf from 14.3 bcf at year-end 1997. Proven crude oil and natural gas liquids reserves rose to 3,632 mbbls from 2,479 mbbls in 1997, an increase of 47 percent.

	Reserves ⁽¹⁾		Discounted Value of Estimated Future Net Revenues			
	Oil & NGLs (mbbls)	Natural Gas (bcf)	(\$ millions)			
			0%	10%	15%	20%
<i>Proven producing</i>	3,606	18.0	66.4	45.0	39.0	34.6
<i>Proven non-producing</i>	26	10.5	9.6	6.2	5.1	4.3
<i>Proven undeveloped</i>	—	1.0	1.5	0.9	0.8	0.6
<i>Total proven</i>	3,632	29.5	77.5	52.1	44.9	39.5
<i>Probable ⁽²⁾</i>	473	2.4	10.5	5.4	4.3	3.4
<i>December 31, 1998</i>	4,105	31.9	88.0	57.5	49.2	42.9

(1) Reserves are defined as the aggregate of the Company's working interest and royalty interest before deductions of royalties payable to others.

(2) Probable reserve values were reduced by 50% to allow for risk.

The discounted value of estimated future net revenues determined by McDaniel & Associates utilized McDaniel & Associates' commodity price forecast.

McDaniel & Associates Forecast	1999	2000	2001	2002	2003*
<i>WTI Crude Oil (\$US/bbl)</i>	\$14.50	\$16.50	\$18.50	\$20.00	\$21.00
<i>Edmonton Light Crude Oil (\$Cdn/bbl)</i>	\$20.60	\$22.90	\$25.00	\$26.70	\$28.10
<i>Alberta Average Natural Gas (\$Cdn/mmbtu)</i>	\$ 2.30	\$ 2.40	\$ 2.45	\$ 2.50	\$ 2.55

* Additional commodity prices available from the Company upon request.

Reserve Reconciliation

	Total Proven		Probable		Proven & Probable	
	Oil & NGLs (mbbls)	Natural Gas (bcf)	Oil & NGLs (mbbls)	Natural Gas (bcf)	Oil & NGLs (mbbls)	Natural Gas (bcf)
December 31, 1997	2,479	14.3	957	3.3	3,436	17.6
Revisions	57	(1.5)	(134)	(0.3)	(77)	(1.8)
Acquisitions	1,527	13.6	194	1.1	1,721	14.7
Divestitures	(231)	–	(76)	–	(307)	–
Additions	305	6.1	5	0.7	310	6.8
Production	(505)	(3.0)	–	–	(505)	(3.0)
December 31, 1998	3,632	29.5	946	4.8	4,578	34.3

During 1998, Search added 1,153 mbbls and 15.2 bcf of proven reserves which, on an equivalent basis, replaced production by a factor of 3.3 times. Search's reserve life index, based on year-end reserves and 1998 exit production, was 6.2 years for oil and natural gas liquids and 7.3 years for gas based on proven reserves.

Capital Expenditures

Capital expenditures increased 24 percent to \$23.8 million from \$19.2 million in 1997 reflecting the aggressive drilling and acquisition program conducted in 1998. In the third quarter of 1998, Search completed the acquisition of Alberta 765467 Ltd. from Petro-Canada. As part of the terms of the acquisition, Search committed to subsequent expenditures which resulted in a total acquisition cost of \$12.9 million. The remainder of 1998 capital expenditures were allocated to drilling and completions, and facilities.

Capital Expenditures (\$ thousands)	1998
Land	\$ 1,088
Geological and geophysical	258
Drilling, completions and workovers	5,385
Facilities and equipment	3,177
Acquisitions	12,888
Head office expenditures	1,040
Total finding and development costs	\$23,836

Finding, Development and Acquisition Costs

Search's 1998 combined finding, development and acquisition costs were \$6.85/boe for proven reserves and \$6.59/boe for proven and probable reserves. On a proven basis, Search successfully reduced its finding, development and acquisition costs by 19 percent.

	1998	1997	1996
<i>Net capital expenditures (\$ thousands)</i>	\$23,836	\$19,209	\$14,678
<i>Proven</i>			
<i>Net reserve additions (mboe)</i>	3,478	2,264	1,763
<i>Finding, development and acquisition costs per boe (\$)</i>	\$ 6.85	\$ 8.48	\$ 8.33
<i>Proven plus probable</i>			
<i>Net reserve additions (mboe)</i>	3,617	2,678	2,160
<i>Finding, development and acquisition costs per boe (\$)</i>	\$ 6.59	\$ 7.17	\$ 6.80

management's discussion and analysis

Management's discussion and analysis is a review of the results of operations and the liquidity and capital resources of Search. It should be read in conjunction with the audited financial statements.

Search met many of its financial and operational objectives in 1998, despite the challenging industry environment created by low crude oil prices. A 71 percent increase in daily boe production meant that Search achieved its 1998 production targets. More importantly, this production growth created an economy of scale that significantly reduced the Company's cost structure. On a boe basis, there were major cost reductions in virtually every area of operations. This was a critical achievement in Search's goal of becoming a low cost producer.

Results of Operations

Production Volumes

Production volumes grew dramatically in 1998 as a result of successful drilling and the acquisition of 765467 Alberta Ltd.'s producing reserves from Petro-Canada. A major objective in 1998 was to increase natural gas production to take advantage of favourable pricing. This was achieved through a 125 percent increase in daily gas volumes, the majority from successful drilling and workovers. The success of this drilling program reflects the skill of Search's in-house technical staff and the utilization of 3-D seismic acquired through a seismic option agreement with a senior producer.

<i>Daily Production</i>	<i>1998</i>	<i>1997</i>	<i>% Change</i>
<i>Crude oil (bbls)</i>	1,383	922	50
<i>Natural gas (mcf)</i>	8,206	3,651	125
<i>Total (boe)</i>	2,204	1,287	71

The Company's 1998 exit rate grew by 65 percent from year-end 1997. This growth was achieved not only from the acquisition of 765467 Alberta Ltd. from Petro-Canada, but also as the result of a successful drilling and workover program.

Exit Rate Reconciliation	Crude Oil (bopd)	Natural Gas (mcf/d)
December 31, 1997 production	1,068	5,592
Petro-Canada acquisition	575	1,908
New drilling and workovers	419	6,152
Declines	(478)	(2,622)
December 31, 1998 production	1,584	11,030

Product Pricing

In 1998, the price of West Texas Intermediate (WTI) crude oil opened at U.S. \$17.64/barrel, and began a downward slide to close at U.S. \$12.05 at year end. One mitigating factor was the fall in the Canadian dollar which helped offset some of the impact of low oil prices.

Average Product Prices	1998	1997	% Change
WTI US\$	\$14.43	\$20.60	-30
CDN \$	\$ 1.48	\$ 1.39	-6
Edmonton light per bbl	\$20.10	\$27.80	-28
Search oil price per bbl	\$17.70	\$24.87	-29
Alberta average gas per mcf	\$ 1.96	\$ 1.85	6
Search average gas per mcf	\$ 2.01	\$ 1.88	7
Average price per boe	\$18.60	\$23.31	-20

Petroleum and Natural Gas Sales

Production volumes and product pricing drive the Company's petroleum and natural gas sales. During 1998 the Company dramatically increased production volumes in the face of declining oil prices. The factors that contributed to the 1998 increase in revenue compared to 1997 are illustrated in the following table:

(\$ thousands)

<i>1997 Petroleum and natural gas revenue</i>	<i>\$10,951</i>
<i>Increase in oil volumes</i>	<i>4,112</i>
<i>Decrease in oil price</i>	<i>(3,619)</i>
<i>Increase in gas volumes</i>	<i>3,128</i>
<i>Increase in gas price</i>	<i>393</i>
<i>1998 Petroleum and natural gas revenue</i>	<i>\$14,965</i>

Royalties

Royalties represent Crown, freehold and overriding burdens on the Company's production. Royalties remain constant as a percentage of revenue, but vary in total according to changes in oil and gas prices and growth in production volumes. Royalties paid in 1998 were slightly lower than in 1997 on both a percentage and boe basis. This was due to the Company's eligibility for a full year of ARTC on properties acquired through the 1997 acquisition of Lionheart Energy Corp.

(\$ thousands, except where noted)

	<i>1998</i>	<i>1997</i>
<i>Total royalties, net of Alberta Royalty Tax Credit (ARTC)</i>	<i>\$ 2,002</i>	<i>\$ 1,569</i>
<i>As a percentage of revenue</i>	<i>13%</i>	<i>14%</i>
<i>Per boe</i>	<i>\$ 2.49</i>	<i>\$ 3.34</i>

Operating Costs

Operating costs fell 26 percent on a boe basis to \$6.20, a decline that surpassed the Company's target for 1998. Reducing operating costs was a major objective for the year and Search aggressively pursued two cost reduction efforts: divesting a number of high cost properties, and hiring experienced field foremen in key operating areas in S.E. Saskatchewan and Central Alberta. Another factor in the decline in boe costs was production growth in such operating areas as Wainwright and Morrisview, and completion of a central processing battery at Pierson.

<i>(\$ thousands, except where noted)</i>	1998	1997
<i>Operating costs</i>	\$ 4,989	\$ 3,927
<i>As a percentage of revenue</i>	33%	36%
<i>Per boe</i>	\$ 6.20	\$ 8.36

General and Administrative

General and administrative expenses declined 10 percent on a boe basis. Overall expenses increased as Search added new employees to handle the Company's asset and production growth and higher levels of field activity. People were hired in all aspects of operations including field staff in core areas and administrative staff due to the acquisition of 765467 Alberta Ltd. from Petro-Canada. Operating and capital recoveries were up as a result of the Company's increased cash capital expenditures in the year. Capitalized general and administrative expenses were higher as the total number of technical employees increased as a percentage of total employees.

<i>(\$ thousands, except where noted)</i>	1998	1997
<i>Gross general and administrative</i>	\$ 2,803	\$ 1,950
<i>Less: operating and capital recoveries</i>	673	576
<i>Less: capitalized</i>	1,040	668
<i>Net general and administrative</i>	1,090	706
<i>As a percentage of revenue</i>	7%	6%
<i>Per boe</i>	\$ 1.35	\$ 1.50
<i>Employees at year end</i>	25	18

Interest

Interest expense increased in 1998 as the Company carried higher average balances on its revolving line of credit. As well, the bank prime rate was 1.7 percent higher than in 1997. However, debt as a percentage of the total value of the Company remained constant. On a boe basis, interest expense declined due to Search's production growing more rapidly than long-term debt.

(\$ thousands, except where noted)

	1998	1997
Year-end long term debt	\$14,350	\$10,000
Year-end market capitalization plus debt (enterprise value)	53,854	35,723
Debt as a percentage of enterprise value	27%	28%
Interest expense	763	550
Per boe	\$ 0.96	\$ 1.19

Depletion, Depreciation and Site Restoration

Depletion, depreciation and site restoration grew in 1998 on a total basis, but declined on a boe produced basis. The decline on a unit basis resulted from the acquisition of reserves at a low cost in 1998.

(\$ thousands, except where noted)

	1998	1997
Depletion and depreciation on oil and gas properties	\$ 5,102	\$ 3,163
Depreciation on office equipment	68	15
Site restoration	242	125
Depletion, depreciation, and site restoration	5,412	3,303
Per boe	\$ 6.73	\$ 7.03

Cash Flow

Cash flow from operations grew 49 percent in 1998, despite a 20 percent drop in product prices. The increase resulted from higher production levels coupled with the 26 percent drop in operating costs. Total cash operating costs were \$11.13/boe, a 24 percent decline from \$14.74/boe in 1997. Despite these cost decreases, weak oil prices contributed to a reduction in cash flow per boe, and a decrease in cash flow per share.

	1998	1997
Cash flow from operations (\$ thousands)	\$ 6,009	\$ 4,028
As a percent of revenue	40%	37%
Per boe	\$ 7.47	\$ 8.57
Per share basic	\$ 0.16	\$ 0.18
Per share fully diluted	\$ 0.15	\$ 0.17

Net Earnings

Search generated net earnings in 1998 despite record low oil prices. This was accomplished through diligent attention to reducing cash operating costs. The Company's positive earnings are a reflection of its historical low cost reserve additions and their impact on depletion and depreciation.

	1998	1997
Net income (\$ thousands)	\$ 597	\$ 725
As a percent of revenue	4%	7%
Per boe	\$ 0.74	\$ 1.54
Per share basic	\$ 0.02	\$ 0.03
Per share fully diluted	\$ 0.02	\$ 0.03

Net Asset Value The Company's net asset value is based upon an independent reserve evaluation conducted by McDaniel & Associates Consultants Ltd. dated January 1, 1999. Undeveloped land was independently evaluated by Seaton-Jordan & Associates Ltd., also dated January 1, 1999. No value has been assigned to the Company's \$51 million of tax pools or the extensive 2-D and 3-D seismic database.

Based on escalating prices (\$ thousands, except where noted)	At 10%	At 15%
Proven producing reserves	\$ 44,984	\$ 39,041
Proven non-producing reserves	6,185	5,123
Proven undeveloped reserves	938	753
Total proven reserves	52,107	44,917
Total probable reserves – risked at 50%	5,450	4,288
Total reserve value	57,557	49,205
Undeveloped land	5,490	5,490
Working capital	303	303
Long-term debt	(14,350)	(14,350)
Net asset value	\$ 49,000	\$ 40,648
Basic shares outstanding (thousands)	46,832	46,832
Net asset value per share (\$)	\$ 1.05	\$ 0.87

Liquidity and Capital Resources

While 1998 was characterized as a year of a relentless fall in oil prices, 1999 dawned with oil prices solidly entrenched at all-time lows. The 12-month forward strip for WTI on the NYMEX went as low as \$11.75/bbl in February 1999. It is very difficult for oil companies to be profitable, let alone grow, with prices at these levels.

Natural gas prices have been much stronger than oil prices, although the outlook indicates some volatility. In 1998, the Company took advantage of more favourable gas pricing and focused on gas activities. In 1999, the majority of capital spending will be dedicated to natural gas.

In 1998, the Company saw declining oil prices translate into reduced access to equity financing and took steps to prepare for this environment. The acquisition of 765467 Alberta Ltd. from Petro-Canada added solid producing assets with demonstrable upside, and was completed at a low cost and without adding debt. A number of high operating cost and/or low working interest properties were sold during the year for full value. Capital expenditures were even more rigidly screened and, when deemed unnecessary, were deferred.

The Company's capital expenditures budget is largely determined by its cash flow. Cash flow is greatly affected by prices received for oil and gas and, to a lesser extent, on the Cdn. dollar exchange rate and interest rates. Search will be very cautious in ramping up capital spending in response to short term increases in oil and gas prices. Any excess cash flow generated by price increases will be used to reduce debt. However, should a new equilibrium price for oil or gas become apparent during 1999, capital expenditures will be adjusted accordingly.

Sensitivities

	<i>Cash Flow</i> <i>(thousands)</i>	<i>Cash Flow</i> <i>Per Share</i>
<i>Change of \$US1.00/bbl in WTI</i>	\$730	\$0.02
<i>Change of \$0.10/mcf in the Alberta average gas price</i>	\$346	\$0.01
<i>Change of \$US0.01 in the US/Cdn exchange rate</i>	\$146	—
<i>Change of one percent in interest rates</i>	\$205	—

Going into 1999, the Company has established a capital expenditure budget of \$19.0 million. Approximately \$6.7 million was spent in mid-March when Search closed an acquisition of properties in the Stoddart/North Pine area of B.C. This acquisition will add about 535 boed of production, operated infrastructure and numerous multiple zone, low risk opportunities. The remaining \$12.3 million will be spent on lower risk projects, mostly natural gas.

Funding in 1999 will come from a combination of cash flow and available lines of credit. Search has established a \$22.0 million line of credit with its bank, of which \$14.35 million was drawn at December 31, 1998.

Cash flow for 1999 is estimated to be between \$10.0 and \$11.0 million, assuming an average oil price of U.S. \$13.00 WTI and an Alberta average gas price of \$2.40/mcf, with production averaging 18 mmcfd and 1,600 bopd or 3,400 boed. With low oil prices continuing in 1999, Search will be very cautious in its capital spending.

The Company will continue to seek full value as it disposes of low working interest, fully developed or high operating cost properties. This disposition program is expected to contribute approximately \$5.0 million in 1999. These funds will be used to reduce bank lines of credit or provide capital for additional strategic acquisitions.

Industry Risks The oil and gas industry is inherently risky. These risks include the uncertainty of finding new reserves, the volatility of commodity prices, accessing markets to sell hydrocarbons, government regulations, royalty and tax legislation, and competitors with greater financial resources. An added risk in 1999 is the year 2000 (Y2K) computer issue and the potential impact on Company-operated assets and on Search's key business partners. The Company attempts to mitigate these risks in a number of ways.

Search employs highly competent employees in all disciplines, engages industry recognized financial and legal advisors, uses leading edge technology to enhance analysis, maintains and monitors forward looking budgets and carries appropriate levels of business and property insurance. The Company also has a dedicated and experienced Board of Directors, who readily offer their knowledge to the senior management team.

Year 2000

The year 2000 problem revolves around the fact that some computer hardware and software has been designed to recognize dates using only the last two digits of the year. It is thought that in the year 2000, many computer systems and programs will fail or not function properly. Search views this as a significant business issue, and has developed plans to limit the risks associated with the turn of the millennium.

The Company has formed a Y2K committee with representatives from each of the departments most at risk in the organization. This committee is chaired by a member of the senior management team, and has full support of the Board of Directors.

The committee has developed plans to secure the Company's in-house operating information consisting largely of land and accounting data, and some technical operating data. The operating systems to secure this information have been warranted by the vendors to be Y2K compliant. However, the committee is planning an extensive testing program for verification. The committee has also developed a back-up system to ensure the data is secure. Contingency plans have been developed by the committee to ensure the Company can operate in early 2000 if systems fail.

The committee is completing an inventory of all of Search's material office and field hardware with internal operating systems that might have a Y2K risk. The manufacturers of these products will be approached to provide Y2K status. Equipment that is not compliant will be replaced.

Search is also concerned about the Y2K status of its key business partners. These partners include banks, utilities, purchasers of products, pipeline companies and various government agencies. Plans are to survey these partners to determine their Y2K readiness, and to take the necessary steps to protect the Company in the event of any non-compliance.

The total cost of developing the Company's Y2K plan has not been finalized, but the current estimate is \$50,000. These costs will be expensed when occurred. This estimate does not include the cost of replacing any non-compliant equipment, an amount that has not yet been determined.

Management's Report

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles using estimates and careful judgement where necessary.

In the opinion of management, the consolidated financial statements have been prepared according to generally accepted accounting principles within accepted limits of materiality. Management has established and maintains a system of internal controls to ensure that transactions are authorized, assets are safeguarded and that the financial information is reliable and accurate.

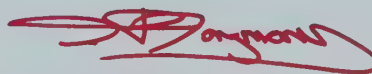
The external auditors, Ernst & Young LLP, appointed by the shareholders, have examined the consolidated financial statements. The Audit Committee consisting of non-management directors, has reviewed these statements with management and the auditors and has reported to the Board of Directors. The Board of Directors has approved the consolidated financial statements.



William T. Davis

President and Chief Executive Officer

March 5, 1999



Jeffrey P. Jongmans

Chief Financial Officer

Auditors' Report

To the Shareholders of Search Energy Corp.

We have audited the consolidated balance sheets of Search Energy Corp. as at December 31, 1998 and 1997 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financials statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Einst + Young LLP

Calgary, Canada

Chartered Accountants

March 5, 1999

Consolidated Balance Sheets

As at December 31

Assets

Current

Cash	—	233,153
Accounts receivable	5,539,759	3,039,022
Deposit (note 11)	2,450,000	—

Property and equipment (notes 3 and 4)

7,989,759	3,272,175
48,472,714	31,357,746
56,462,473	34,629,921

Liabilities

Current

Bank indebtedness	1,141,688	—
Accounts payable and accrued liabilities	6,544,608	3,647,038

Long term debt (note 5)

Provision for future site restoration

7,686,296	3,647,038
14,350,000	10,000,000
900,556	701,364
22,936,852	14,348,402

Shareholders' Equity

Share capital (notes 4 and 6)

Retained earnings

Commitments (note 9)

32,129,402	19,364,799
1,396,219	916,720
33,525,621	20,281,519
56,462,473	34,629,921

See accompanying notes

On behalf of the board



Director



Director

Consolidated Statements of Operations and Retained Earnings

For the years ended December 31

Revenue

Petroleum and natural gas sales	14,965,000	10,951,295
Royalties, net of Alberta Royalty Tax Credit	(2,002,192)	(1,569,037)
	12,962,808	9,382,258

Expenses

Operating costs	4,989,336	3,927,464
General and administrative	1,089,613	706,243
Interest	763,080	550,430
Depletion, depreciation and site restoration	5,411,986	3,303,107
	12,254,015	8,487,244
Income before taxes	708,793	895,014
Corporate taxes (note 7)	112,260	170,147
Net income	596,533	724,867
Retained earnings, beginning of year	916,720	191,853
Excess of redemption price over carrying value of common shares	(117,034)	—
Retained earnings, end of year	1,396,219	916,720
Earnings per share (note 8)		
Basic and fully diluted	0.02	0.03

See accompanying notes

Consolidated Statements of Cash Flows

For the years ended December 31

Operating Activities

	1998 \$	1997 \$
Net income	596,533	724,867
Add items not requiring cash:		
Depletion, depreciation and site restoration	5,411,986	3,303,107
Cash flow from operations	6,008,519	4,027,974
Changes in non-cash working capital	470,517	(1,813,170)
Cash provided by operating activities	6,479,036	2,214,804

Financing Activities

Issue of shares for Petro-Canada subsidiary (note 4)	11,991,643	–
Issue of flow-through shares for cash (note 6)	3,260,000	1,497,700
Issue of common shares to acquire Lionheart (note 4)	–	10,975,000
Issue of common shares for cash	9,000	77,070
Exercise of warrants	–	58,333
Shares cancelled pursuant to issuer bid	(884,354)	–
Share issue costs (note 6)	(294,320)	(139,642)
Increase in long term debt	4,350,000	1,500,000
Long term debt assumed on acquisition of Lionheart	–	3,360,000
Changes in non-cash working capital	(2,450,000)	–
Cash provided by financing activities	15,981,969	17,328,461

Investing Activities

Acquisition of Petro-Canada subsidiary (note 4)	(10,171,224)	–
Acquisition of Lionheart (note 4)	–	(16,453,000)
Expenditures on property and equipment, net of disposals	(13,664,622)	(2,756,086)
Cash used in investing activities	(23,835,846)	(19,209,086)
Net (decrease) increase in cash	(1,374,841)	334,179
Cash (bank indebtedness), beginning of year	233,153	(101,026)
Cash (bank indebtedness), end of year	(1,141,688)	233,153
Cash flow from operations per share (note 8)		
Basic	0.16	0.18
Fully diluted	0.15	0.17

See accompanying notes

Notes to Consolidated Financial Statements

For the years ended December 31, 1998 and 1997

1 Operations

Search Energy Corp. ("Search" or the "Corporation") was continued in 1994 under the laws of the Province of Alberta. The Corporation's business is the acquisition of, and the exploration for and development and production of, crude oil and natural gas in Canada.

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiary.

2 Summary of Significant Accounting Policies

Property and equipment

Petroleum and natural gas properties and related equipment

The Corporation follows the full cost method of accounting in accordance with the guideline issued by the Canadian Institute of Chartered Accountants whereby all costs associated with the acquisition of and the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive are capitalized in a Canadian cost centre and charged to income as set out below. Such costs include lease acquisition, drilling, geological and geophysical costs and general and administrative and overhead expenses related to exploration and development activities. Costs of acquiring and evaluating unproved properties are excluded from depletion calculations until it is determined whether or not proven reserves are attributable to the properties or impairment occurs.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion of petroleum and natural gas properties and depreciation of lease and well equipment is provided on accumulated costs using the unit of production method based on estimated proven petroleum and natural gas reserves, before royalties, as determined by independent engineers. For purposes of the depletion calculation, proven petroleum and natural gas reserves are converted to a common unit of measure on the basis of one barrel of oil or liquids being equal to six mcf of natural gas.

The depletion and depreciation cost base includes total capitalized costs, less costs of unproved properties, plus a provision for future development costs of proven undeveloped reserves.

The net carrying value of the Corporation's petroleum and natural gas properties is limited to an ultimate recoverable amount. This amount is the aggregate of estimated future net revenues from proven reserves and the costs of unproved properties, net of impairment allowances, less future estimated production costs, general and administrative costs, financing costs, site restoration and abandonment costs, and income taxes. Future net revenues are estimated using prices and costs without escalation or discounting, and the income tax and Alberta Royalty Tax Credit legislation in effect at the year end.

Furniture and equipment

The Corporation records furniture and equipment at cost and provides depreciation on the declining balance method at a rate of 20% per annum which is designed to amortize the cost of the assets over their estimated useful lives.

Future site restoration

The estimated cost of future site restoration and abandonment is based on the current cost and the anticipated method and extent of site restoration in accordance with existing legislation and industry practice. The annual charge, provided for on a unit of production basis, is accounted for as part of depletion, depreciation and site restoration expense. Actual site restoration expenditures are charged to the accumulated provision account as incurred.

Measurement uncertainty

The amounts recorded for depletion and depreciation of property and equipment and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

Joint operations

The accounts of the Corporation reflect its proportionate interest in exploration and production activities conducted jointly with others.

Income taxes

The Corporation follows the deferral method of tax accounting under which the income tax provision is based on the earnings reported in the accounts. Under this method, the Corporation provides for deferred income taxes to the extent that income taxes otherwise payable are reduced by exploration and development costs and capital cost allowances in excess of the depletion and depreciation provisions recorded in the accounts.

Financial instruments

Financial instruments of the Corporation consist of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and long term debt. As at December 31, 1998 and 1997, there are no significant differences between the carrying amounts reported on the balance sheet and the estimated fair values of the financial instruments.

Flow through shares

A portion of the Corporation's exploration and development activities is financed through proceeds received from the issue of flow through shares. Under the terms of the flow through share issues, the tax attributes of the related expenditures are renounced to the share subscribers. To recognize the foregone tax benefits, the carrying value of the Corporation's petroleum and natural gas properties and the flow through shares issued are recorded net of the tax benefit of the renouncements when the qualifying expenditures occur.

3

Property and Equipment

<i>December 31, 1998</i>			
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
<i>Petroleum and natural gas properties and related equipment</i>	57,404,688	9,190,886	48,213,802
<i>Furniture and equipment</i>	371,515	112,603	258,912
	57,776,203	9,303,489	48,472,714

<i>December 31, 1997</i>			
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	\$	\$	\$
<i>Petroleum and natural gas properties and related equipment</i>	35,357,594	4,046,176	31,311,418
<i>Furniture and equipment</i>	90,847	44,519	46,328
	35,448,441	4,090,695	31,357,746

During 1998, Search capitalized general and administrative expenditures directly related to exploration and development activities of \$1,040,358 (1997 – \$667,955).

Costs of \$7,195,179 (1997 – \$6,330,945) for unproven properties have been excluded from the calculation of depletion expense.

4

Business Acquisitions

(a) Acquisition of Petro-Canada Subsidiary

On September 25, 1998, the Corporation acquired all of the issued and outstanding shares of 765467 Alberta Ltd. ("765467"), a subsidiary of Petro-Canada in exchange for 16,600,000 common shares valued at \$11,991,643 and \$100,000 cash. 765467 was subsequently wound up.

The acquisition has been accounted for by the purchase method, where the fair value of the purchase consideration was allocated to the fair value of 765467's assets. Accrued costs of the acquisition were included in Search's working capital. The purchase price was allocated as follows:

	\$
Purchase Price	12,091,643
Allocated to:	
Property and equipment	7,721,224
Working capital, including deposit (see note 11)	4,370,419
	12,091,643

(b) Acquisition of Lionheart Energy Corp.

On May 2, 1997, the Corporation acquired all of the shares of Lionheart Energy Corp. (Lionheart) under the terms of a Plan of Arrangement in exchange for shares of Search. Lionheart shareholders were issued 0.81 shares of Search for each Lionheart share owned, resulting in 13,840,838 Search shares being issued.

The acquisition has been accounted for by the purchase method, where the fair value of the purchase consideration was allocated to the fair value of Lionheart's assets and liabilities. Accrued costs of the acquisition were included in the working capital deficiency assumed. The purchase price has been allocated as follows:

Number of Shares Issued	13,840,838
	\$
Purchase Price	10,975,000
Allocated to:	
Property and equipment	16,717,000
Working capital deficiency	(2,118,000)
Long term debt	(3,360,000)
Future site restoration costs	(264,000)
	10,975,000

5

Long Term Debt

The Corporation has a \$22,000,000 line of credit consisting of a revolving reducing demand loan with a chartered bank that bears interest at the bank prime rate plus 1/2 percent. Collateral for this line consists of a general security agreement in the amount of \$25,000,000 covering all assets of the Corporation. Under the terms of the facility, the aggregate borrowing limit reduces to \$20,000,000 by December 31, 1999.

At December 31, 1998, the effective interest rate on the outstanding amounts under the facility was 6.3% (1997 – 5.7%).

While the credit facility is demand in nature, the bank has stated that it is not its intention to call for repayment before December 31, 1999 provided that there is no adverse change in the financial position of the Corporation. Accordingly, the loan is classified as long term.

6 Share Capital

Authorized

Unlimited number of Common shares

Unlimited number of Preferred shares issuable in series

	Amount	
	Number	\$
Common Shares		
Balance, January 1, 1997	10,829,473	6,217,787
Acquisition of Lionheart Energy Corp. [note 4 (b)]	13,840,838	10,975,000
Conversion of Special Warrants (a)	2,100,000	1,548,739
Private Placement of Flow Through Shares (c)	1,275,222	1,497,700
Exercise of Warrants	58,333	58,333
Issued for cash	56,000	73,920
Exercise of stock option	4,500	3,150
Tax benefits renounced (c)	—	(870,188)
Share issue costs	—	(139,642)
Balance, December 31, 1997	28,164,366	19,364,799
Acquisition of Petro-Canada Subsidiary [note 4 (a)]	16,600,000	11,991,643
Private Placement of Flow Through Shares (b)	3,155,340	3,250,000
Issued for cash	28,333	19,000
Tax benefits renounced (c)	—	(1,434,400)
Shares Cancelled Pursuant to Issuer Bid (d)	(1,116,000)	(767,320)
Share issue costs	—	(294,320)
Balance, December 31, 1998	46,832,039	32,129,402

- (a) During 1997, 750,000 Series A Special Warrants, 750,000 Series B Special Warrants and 600,000 flow-through Special Warrants that were originally issued in 1996 were converted into 2,100,000 common shares.
- (b) On May 25, 1998 the Corporation completed the private placement of 3,155,340 Units for gross proceeds of \$3,250,000. Each Unit consists of one flow-through common share and 3/4 of one common share purchase warrant. Each whole common share purchase warrant is exercisable, on or before November 25, 1999, into one common share of the Corporation at \$1.16 per share.

- (c) In accordance with the terms of its flow through share offerings, and pursuant to certain provisions of the *Income Tax Act* (Canada), Search intends to renounce, for income tax purposes, exploration and development expenditures incurred to holders of its flow through shares in the aggregate amount of \$3,097,500 (1997 – \$1,497,700). The carrying values of property and equipment and share capital were reduced by \$1,434,400 (1997 – \$870,188) to reflect the tax benefits of the expenditures to be renounced related to the 1998 and 1997 flow-through issuances. At December 31, 1998 eligible expenditures of \$1,003,452 remain to be incurred.
- (d) During 1998, the Corporation purchased and cancelled 1,116,000 of its common shares pursuant to a normal course issuer bid. The \$117,034 excess paid over the \$767,320 carrying value of these shares has been charged to retained earnings.

Options

Under the terms of the Corporation's stock option plan, 4,695,000 shares have been reserved for issuance. The Corporation has granted options to purchase 3,944,500 common shares at exercise prices ranging from \$0.60 to \$1.65 per share. These options expire between 1999 and 2003.

7

Income Taxes

Income taxes recorded on the consolidated statements of operations and retained earnings differ from the tax calculated by applying the combined statutory Canadian corporate federal and provincial income tax rate to income before taxes as follows:

	<i>Years ended December 31,</i>	
	1998	1997
<i>Corporate income tax rate</i>	45%	46%
<i>Computed income tax expense</i>	\$316,986	\$333,439
<i>Increase (decrease) income tax:</i>		
<i>Non-deductible Crown charges, net of ARTC</i>	\$547,482	\$365,832
<i>Resource allowance</i>	(687,644)	(571,131)
<i>Share issue expenses</i>	(258,938)	(183,817)
<i>Benefit of losses not recognized</i>	55,815	55,677
<i>Non-deductible depletion and other</i>	26,299	—
<i>Deferred income tax expense</i>	—	—

At December 31, 1998 the Corporation had non-capital losses of approximately \$2,800,000 available to reduce future years taxable income. The non-capital losses expire as follows: 2002 – \$300,000; 2003 – \$500,000 and 2004 – \$2,000,000.

8 Per Common Share Amounts

The calculation of earnings per share and cash flow from operations per share is based on the weighted average number of common shares outstanding during the year ended December 31, 1998 of 38,050,227 (1997 – 22,549,330). The fully diluted weighted average number of shares outstanding at December 31, 1998 is 42,185,748 (1997 – 24,874,830).

Cash flow from operations per share is based on cash flow from operations before changes in non-cash working capital items.

9 Commitments

The Corporation has entered into an agreement with an industry partner to process the Corporation's natural gas. The agreement has the same term as the Corporation's natural gas reserves in the area and has a non-escalating fee of \$0.40 per mcf processed.

10 Year 2000 Uncertainty

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. Management has developed and is implementing a plan designed to identify and address the expected effects of the Year 2000 Issue on the Corporation. An assessment of the readiness of third parties such as customers, suppliers and others is ongoing. However, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

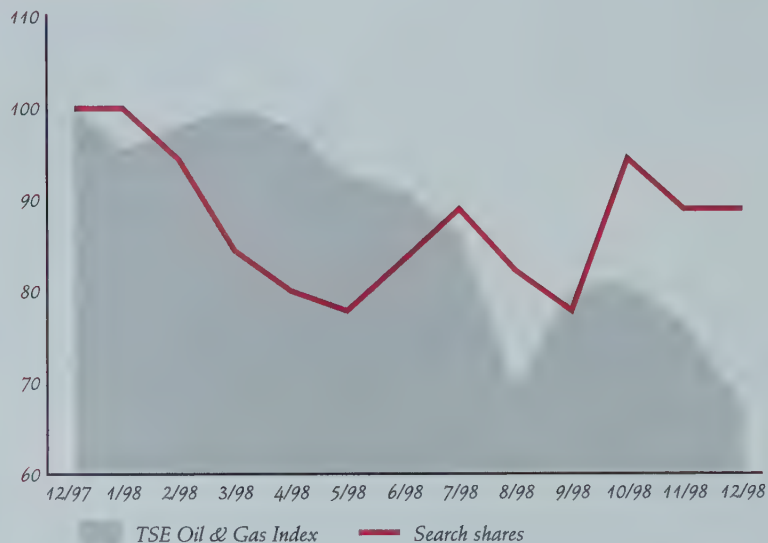
11 Subsequent Event

On March 15, 1999, the Corporation completed the purchase of certain oil and gas properties from Petro-Canada for cash consideration of approximately \$6.7 million.

The deposit recorded on the December 31, 1998 balance sheet has been applied against the \$7.5 million purchase price.

Search versus TSE Oil & Gas Index

Percentage Change in Price (%)



Search 1998 Trading History

Share Price (\$)

	High	Low	Close	Volume
January	0.90	0.75	0.90	516,334
February	0.90	0.75	0.85	485,709
March	0.85	0.75	0.75	455,760
April	0.89	0.70	0.73	607,580
May	0.80	0.70	0.70	437,830
June	0.82	0.68	0.75	482,796
July	0.80	0.70	0.80	1,178,694
August	0.80	0.70	0.75	630,372
September	0.75	0.67	0.68	699,619
October	0.85	0.60	0.85	2,727,142
November	0.95	0.80	0.90	1,405,232
December	0.92	0.65	0.85	619,328
				10,246,396

Notice of Annual General Meeting

*Shareholders and guests are invited to attend
the Annual General Meeting to be held on
Tuesday, June 1, 1999 at 3:00 p.m. in the
Viking Room of The Calgary Petroleum Club,
310 - 5th Avenue S.W., Calgary, Alberta.*

Abbreviations

<i>bbls</i>	<i>barrels</i>
<i>bopd</i>	<i>barrels of oil per day</i>
<i>mbbls</i>	<i>thousand barrels</i>
<i>mmbbls</i>	<i>million barrels</i>
<i>boe</i>	<i>barrels of oil equivalent (10 mcf = 1 bbl)</i>
<i>mboe</i>	<i>thousand barrels of oil equivalent</i>
<i>boed</i>	<i>barrels of oil equivalent per day</i>
<i>mcf</i>	<i>thousand cubic feet</i>
<i>mmbtu</i>	<i>million British thermal units</i>
<i>mcfd</i>	<i>thousand cubic feet per day</i>
<i>mmcf</i>	<i>million cubic feet</i>
<i>mmcfd</i>	<i>million cubic feet per day</i>
<i>bcf</i>	<i>billion cubic feet</i>
<i>NGLs</i>	<i>natural gas liquids</i>
<i>WTI</i>	<i>West Texas Intermediate</i>

Five Year Performance Review

As at December 31

Operations

Daily production

Oil & NGLs (bbls)

1,383

922

258

Natural gas (mcf)

8,206

3,651

373

Average production (boe)

2,204

1,287

295

Reserves

Proven (mboe)

6,582

3,905

2,111

Proven plus risked probable (mboe)

7,295

4,518

2,551

Finding, development and acquisition costs

Proven (\$/boe)

6.85

8.49

8.32

Proven plus risked probable (\$/boe)

6.72

7.77

6.66

Wells drilled

Gross

25.0

14.0

6.0

Net

17.8

6.6

4.5

Undeveloped land

Acres (net)

112,150

60,799

40,121

Financial

Total revenue (\$ thousands)

14,965

10,951

2,683

Average product price (\$/boe)

18.60

23.31

24.92

Cash flow from operations (\$ thousands)

6,009

4,028

832

Per share (\$)

0.16

0.18

0.18

Earnings (\$ thousands)

597

725

192

Per share (\$)

0.02

0.03

0.04

Shares outstanding (thousands)

46,832

28,164

12,929

Year end debt, including working capital (\$ thousands)

14,047

10,375

7,662

Debt to cash flow multiple

2.34

2.58

9.21

Operating costs (\$/boe)

6.20

8.36

8.73

Net G & A (\$/boe)

1.35

1.50

2.69

Interest expense (\$/boe)

0.96

1.19

0.60

Cash flow netback (\$/boe)

7.47

8.57

7.72

1995	1994
69	—
266	295
96	29
454	5
500	5
3.42	—
2.84	—
2.0	—
1.0	—
1,280	—
675	180
19.26	17.05
53	56
0.02	0.05
(648)	(139)
(0.28)	(0.13)
3,305	1,015
580	435
10.94	7.77
9.90	5.54
4.08	5.56
0.72	—
1.52	5.19

Search Energy's strong track record of growth has been based on acquiring high potential assets followed by technically sound exploration and development.

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Corporate Information

Board of Directors

Gary F. Aitken⁽¹⁾⁽²⁾
Calgary, Alberta

William T. Davis⁽²⁾
Calgary, Alberta

Ronald A. McIntosh⁽³⁾
Calgary, Alberta

Roderick M. Myers⁽³⁾
Calgary, Alberta

Daniel U. Pekarsky⁽¹⁾⁽²⁾
Vancouver, B.C.

Rodger A. Tourigny⁽¹⁾⁽³⁾
Calgary, Alberta

⁽¹⁾ Member of Audit Committee
⁽²⁾ Member of Compensation Committee
⁽³⁾ Member of Independent Reserve
Evaluation Committee

Officers and Management

William T. Davis
President and Chief Executive Officer

Nicholas R. Wemyss
Vice President, Exploration

Roderick M. Myers
Vice President, Business Development

Jeffrey P. Jongmans
Chief Financial Officer

Douglas A. Barry
Vice President, Engineering & Operations

Brian W. Mainwaring
Corporate Secretary

Executive Offices

Suite 700, 400 - 5th Avenue S.W.
Calgary, Alberta T2P 0L6
Tel: (403) 261-8810
Fax: (403) 262-0723
Email: search@searchenergy.com
Website: www.searchenergy.com

Banker

National Bank of Canada
Calgary, Alberta

Solicitors

Code Hunter Wittmann
Calgary, Alberta

Auditors

Ernst & Young LLP
Chartered Accountants
Calgary, Alberta

Independent Engineers

McDaniel & Associates Consultants Ltd.
Calgary, Alberta

Registrar and Transfer Agent

Montreal Trust Company of Canada
Calgary, Alberta

Stock Exchange Listing

The Toronto Stock Exchange
Symbol: SGY